Minutes of the Monetary Policy Committee Meeting (MPC)/02/05)

April 28, 2005

The second meeting of the Monetary Policy Committee (MPC) in 2005 was held in the Conference Room of the Bank on April 28-29, 2005.

Present were:

Famara L. Jatta	-	Governor (Chairman)
Momodou .B. Saho	-	Member
Ousman Sowe	-	Member
Basiru Njai	-	Member
Amadou Colley	-	Member
Mod Secka	-	Member
Buah Saidy	-	Secretary

In attendance were:

Momodou A. Ceesay	-	Adviser	Governor's Office
Oumie Savage-Samba	-	Director	FISD
Omar Jatta	-	Deputy Director	FED
Mr. Brownbridge	-	Adviser	DOSFEA
Alieu Gaye	-	Deputy Director	BSD
Essa Drammeh	-	Deputy Director	FSD
Haddy Joof	-	Deputy Director	AHRD
Ousainou Corr	-	Deputy Director	FISD
Amadou Koora	-	Senior Bank Examiner	FSD
Awa Jagne Jarjusey	-	Bank Examiner	FSD
Karamo Jawara	-	Senior Banking Officer	BSD
Bakary Kolley	-	Senior Economist	ERD

Ismaila Jarju	-	Senior Economist	ERD
Bakary Jammeh	-	Senior Economist	ERD
Ebrima Wada	-	Senior Economist	ERD
Maimuna John Sowe	-	Senior Economist	ERD
Momodou Sabally	-	Senior Economist	ERD
Buba Touray	-	Economist	ERD

Opening

The Chairman opened the meeting by welcoming members to the second session of the MPC in 2005. He urged Committee members to discuss the issues exhaustively in order to arrive at a well-informed decision.

Before turning to its immediate policy decision and against the background of the forward looking business sentiment survey and the latest output and inflation projections, the Committee discussed balance of payments (BOP), fiscal, money market, monetary, banking sector and international developments.

(1.0) World Economic Outlook

The world economy is expected to grow by 4.3 per cent in 2005 supported by recovery in the Euro area, Japan and the US as well as strengthening activity in emerging Asia, particularly China.

Recent economic data on Africa's economy indicated that performance has been robust. The IMF estimated that growth was close to 5.1 per cent in 2004 and prospects in 2005 are strong premised on prudent implementation of macroeconomic policies, buoyant commodity prices, improved weather conditions and debt relief under the HIPC initiative.
The Committee noted the favourable economic performance, but judged that more needs to be done to sustain the high growth rate. For example, there are

significant risks to the outlook, including civil conflicts in the region, vulnerability of many countries to droughts and other national disasters and uncertainties in the foreign exchange and oil markets. More importantly, the key to Africa's growth prospects in the medium to long-term is comprehensive structural reforms, particularly given the fact that the recent good news in Africa stems primarily from domestic reforms initiated by African Governments. Reforms should significantly boost investment, particularly foreign direct investment (FDI) from its current low level to the magnitude necessary for sustained economic growth and poverty reduction.

The investment rate in The Gambia averaging 19.0 per cent of GDP in the decade to 2004 was deemed too low especially when compared to rates hovering around 30-35 per cent of GDP in emerging Asian countries. It is, therefore, essential to carryout a comprehensive, albeit well sequenced structural reforms to create a more conducive environment for increased private sector investment in The Gambia.

The Committee lamented the trade dispute between China and Europe, following a similar row between the United States and China fearing that if the disputes are not amicably settled, international trade may be stifled. The US and Europe viewed the surge in Chinese exports as mere dumping and are, therefore, afraid that if the problem is not addressed their manufacturing base would be "hallowed". The overwhelming sentiment of the Committee, however, was that the dumping argument may not hold water taking into account the competitiveness of the Yuan, which is fixed to the Dollar, but more fundamentally, the fact that given its abundant supply of labour, China enjoys a comparative advantage in the manufacture of labour intensive goods. Even if the Yuan is revalued, the attendant decrease in the cost of commodity imports would make Chinese exports competitive still.

Inflation and inflationary expectations remained generally subdued with few signs of pass through from higher oil prices. Given that most central banks have proactively tightened monetary policy and with inflationary expectations well grounded, the outlook for higher consumer prices remain moderate. The stability in exchange rates, particularly in small open economies has also been instrumental in putting a lid on inflationary pressures.

(2.0) Balance of Payments (BOP)

Latest data indicate that the overall BOP would be higher-than-expected owing to an anticipated increase in foreign direct investment (FDI) inflows. Given the strong correlation between FDI and growth, the Committee expressed the need to continuously improve the investment climate to scale up FDI flows.

The Committee welcomed the steps taken by the Economic Research Department to migrate from BOP Manual 4 to BOP Manual 5 and urged that greater effort be made to improve data quality and timeliness.

(3.0) Foreign Exchange Developments

The major development in the inter-bank foreign exchange market was the marked decline in sales, indicative of demand, in the first quarter of 2005 relative to the fourth quarter of 2004. This development was attributed to the fact that given that the Central Bank observed its net foreign assets and net usable reserves targets, it participated little in the inter-bank foreign exchange market.

The supply of foreign exchange is likely to increase in the months ahead owing to the expected surge in non-traditional exports, particularly cashew nuts. The Committee noted that groundnut exports have not commenced despite the fact that over 30,000 tonnes of nuts have already been purchased. However, should exports start in earnest, the attendant increase in foreign receipts, coupled with the prevailing tight monetary policy stance, should cause the Dalasi to appreciate in the months ahead.

In the year to end-March 2005, the Dalasi was quite stable depreciating against the Pound Sterling and the Euro by only 1.1 per cent and 1.7 per cent respectively. The Dalasi, however, appreciated against the US Dollar by 2.9 per cent.

(4.0) Fiscal Developments

Domestic revenue increased to D646.6 million, or 5.0 per cent over the previous quarter. However, in the year to end-March 2005 domestic revenue rose by only 1.2 per cent. Although tax revenue decreased by 3.3 per cent, there was an offsetting 50.6 increase in non-tax revenue. There was a discernible decrease in oil and oil related taxes, attributed partly to the fact that the authorities have not passed the increase in oil prices to consumers and partly to the increase in duty waivers. Better-than-expected revenue from vehicle licenses and related road taxes caused the marked increase in non-tax revenue.

The fiscal data also indicated higher-than-programmed expenditure, budget deficit and domestic borrowing in the first quarter. The large gross fiscal deficit was a cause for concern from the viewpoint of overall macro-economic stability. Prudent management required the deficit to be reduced substantially by deepening the fiscal consolidation process. To better guage fiscal developments, the Committee expressed the need for a more detailed trend analysis of fiscal data.

The Committee applauded the decision to re-assign the responsibility for selling state land to the Department of State for Finance and Economic Affairs (DOSFEA) in the hope that it would significantly speed - up the process as well as ensuring that receipts meet the set targets.

(5.0) Money Market Developments

The stock of interest bearing debt as at end-March 2005 rose to D5.2 billion, or 15.6 from end-December 2004. Compared to a year earlier, the debt stock increased by 52.9 per cent. The Committee noted that the development stocks maturing at end-May 2005, should not be rolled over as it would not significantly impair Government's position with the Central Bank.

Given the spiraling domestic debt and the need to free resources for private sector lending, the importance of fiscal consolidation was reiterated. In point of fact, the domestic debt would have been much higher, but for the significant under-subscription in past auctions.

(6.0) Monetary Developments

The latest monetary data showed robust growth in the main aggregates. Growth in money supply accelerated to 24.0 per cent in the year to end-February 2005 reversing the easing experienced in 2004. However, the growth rate was much lower-than the 31.5 per cent recorded a year ago. Both components of money supply increased.

Narrow money, reflecting current pressures in the economy, rose by 19.5 per cent but was lower-than the 34.5 per cent growth rate a year ago. Currency issued and demand deposits increased by 16.3 per cent and 22.5 per cent respectively. However, the ratio of narrow money (M1) to broad money (M2) declined from 60.6 per cent at end-February 2004 to 58.5 per cent at end-February 2005.

Quasi money rose by 30.9 per cent, higher-than the 27.2 per cent growth rate a year ago. Correspondingly, the share of quasi money to broad money rose from 39.4 per cent at end-February 2004 to 41.5 per cent at end-February 2005.

There were differing interpretations of the monetary data. An observation was made that the increase in money supply was as a result of seasonality factors and should trend downward in the second and third quarter of the year. The implication is that the acceleration in money supply poses little threat to inflation. The other view point was that the higher-than-programmed growth of money implied risks to the outlook for inflation which suggests taking proactive steps to put it under control.

Credit to the private sector decreased by 3.6 per cent reflecting in large part high real interest rates. The expectation is that supportive fiscal policies in the second half of the year, coupled with a benign inflationary environment should cause interest rates to decline rapidly leading to increased private sector lending. In other words, if inflation rates continue to remain low over a reasonable period of time, credibility of policies would be established and nominal interest rates would automatically come down at a robust pace.

Reserve money, the Bank's operating target, grew by 15.6 per cent. This growth rate though higher-than-programmed, was lower-than the substantial growth rate of 34.2 per cent a year ago.

(7.0) Financial Stability

The average capital adequacy ratio was 82.8 per cent at end-March 2005 compared to 20.3 per cent in the previous quarter. The substantial increase was attributed to the entry into the sector of a well capitalized bank with virtually no risky assets. The lowest ratio was 13.4 per cent and the highest 444.2 per cent. Excluding the new bank, the ratio declined to 19.4 per cent. Thus, all the banks were above the minimum capital requirement of 8.0 per cent, implying that there was enough cushion for loan losses.

Total assets of the banks' increased to D6.9 billion, or 3.9 per cent from the previous quarter. Compared to a year ago, total assets rose by 22.5 per cent. Loans and advances accounted for 22.8 per cent of total assets, a marked drop from the 29.1 per cent a year earlier.

Non-performing loans totaled D179.1 million, reflecting a decrease of D31.8 million over the previous quarter. More importantly, actual provisioning was D137.6 million, much higher-than the recommended provisioning of D122.4 million. All the banks except one recorded excess provisioning. This improvement was attributed to the strong stance of the regulatory authorities in ensuring that the regulations on provisioning are fully adhered to.

The industry's return on assets rose to 4.7 per cent compared to 1.2 per cent in the previous quarter attributed to profits increasing faster than total assets. Return on equity was 9.1 per cent, lower-than the 13.0 per cent in the preceding quarter owing primarily to increased equity.

The Committee noted that the fundamentals of the banking sector remain solid but that interest rate spreads are disturbingly high, which partly explains the high profitability of banks. Given the exposure of banks to foreign exchange risks, it was thought necessary to include in the financial stability report analysis of net foreign exchange exposure of banks.

(8.0) Real Sector

Recent information indicate an unrevised GDP growth of 5.0 per cent in 2005. Output growth is projected to be broad based: agriculture (4.7 per cent), manufacturing (6.0 per cent), electricity and water (5.0 per cent), trade (5.6 per cent) and hotels and restaurants (10.0 per cent).

It was observed that the volatility of growth declined significantly between 1985-1995, lower-than any country in sub-Saharan Africa. Volatility was quite pronounced between 1996-2004 caused partly by external shocks, but more fundamentally by frequent set backs in economic reforms. The view was also expressed that it was not only the implementation of appropriate policies that caused the growth rate to be stable in the decade to 1995, but massive donor support in the context of strong reform efforts. This, the argument goes, underscores the importance of appropriate policies in mitigating the impact of stocks.

To achieve a high and sustainable growth necessary for poverty reduction, it is crucial to unleash the potentialities of the under-performing sectors, particularly the fisheries sector. It was noted that while the artesanal fisheries sector is doing relatively well, the industrial sector is mired in low growth thanks to unreliable power supply, poor management and the lack of a fishing port. The bulk of the industrial output is produced by foreign fishing vessels, which land the catch in foreign ports.

(9.0) Business Sentiment Survey

The most recent business sentiment survey indicated higher activity at both the company and country level in quarter 1, 2005 relative to quarter 4, 2004. Respondents also reported higher capital expenditure, employment, sales and profits.

Panel firms expectations on inflation, exchange rates and interest rates were more positive than in the previous survey attributed to the declining trend in inflation and the strengthening of the Dalasi.

Noteworthy was the construction industry's high inflationary expectation. This was attributed to the intermittent shortage of cement owing to a surge in demand and the concomitant increase in the retail price of the product.

(10.0) Inflation

End-period inflation, measured by the consumer price index, declined from 17.7 per cent in February 2004 to 5.7 per cent at end-February 2005. Average inflation rate (12 month moving average) was 12.2 per cent compared to 17.9 per cent a year ago.

Food consumer prices declined to 6.7 per cent compared to 19.4 per cent in February 2004. Non-food inflation also decelerated to 3.5 per cent compared to 14.6 at end-February 2004.

Core inflation 1, which excludes prices of energy (fuel, light and transport) declined from 15.8 per cent in February 2004 to 4.6 per cent in February 2005. Core inflation 2, which strips out prices of energy and volatile food items decelerated to 0.9 per cent relative to 12.2 per cent in February 2004. Seasonally adjusted inflation also declined to 5.8 per cent, much lower-than the 17.9 per cent recorded in February 2004.

(10.1) Prospects for Inflation

Despite the marked increase in oil and non-oil commodity prices, global inflationary pressures remain weak. Manufactured good prices are subdued thanks in part to the massive supply of goods to the global market by China.

The Dalasi exchange rate remains stable owing partly to the increase in foreign inflows and partly to the prevailing tight monetary policy stance. Given the improved macroeconomic conditions, the Dalasi is expected to hold steady through out the year.

Growth in money supply accelerated to 24.0 per cent in the year to end-February 2005 reversing the declining trend experienced in 2004. However, the expectation is that money supply growth would decelerate close to the target of 10.0 per cent at end-December 2005.

Government expenditure was higher-than programmed in the first quarter of 2005 which caused a deterioration in Government's position with the banking sector. If corrective fiscal measures are implemented, Government expenditure and net lending target of 26.0. per cent of GDP at end-December 2005 would be realized.

The short-term - error correction model (ECM) was used to forecast inflation. The model assumes:

(i) Year-on-year growth in money supply of 10.0 per cent (ii) Government expenditure and net lending of 26.0 per cent of GDP and zero Central Bank financing of the budget deficit and (iii) stable exchange rate for the entire 2005.

End-June 2005 inflation is forecast at 2.4 per cent, declining to 1.6 per cent by end- December 2005. However, given the fiscal slippages experienced in quarter 1, 2005, the balance of risk assessment increased to 1.14 compared to 1.0 in the previous assessment.

(11.0) Decision

Inflationary pressures continued to ease with end-period headline inflation declining to 5.7 per cent at end-February 2005 compared to 17.7 a year earlier. Looking ahead, the Committee observed that the disinflationary trend observed over the past 12 months runs the risk of reversal given the risks associated with oil price volatility, but more fundamentally fiscal slippages.

Taking the above factors into consideration including the risks to the inflation outlook, the MPC decided to maintain the rediscount rate, the policy rate, at 29.0 percent. The MPC would continue to monitor the situation and if the outlook changes, the Committee would review its stance.

ANNEX A

(1.0) World Economic Outlook

A. World Output

The expansion in the global economy moderated in the first quarter of this year following solid expansion in 2003 and 2004. Both industrial production and global trade have eased signaling a return to more sustainable rates of growth and the impact of rising oil prices. Despite moderating growth, oil prices remain high and largely volatile. Looking forward, there are signs that the global economy will remain solid in 2005, although there are upside risks, including higher oil prices.

The world economy is expected to grow by 4.3 percent in 2005 and 2006, supported by recovery in the euro area, Japan and the US, as well as strengthening activity in emerging Asia, particularly China.

In the US, growth has been stronger than expected driven by strong domestic demand. Industrial production rose 0.3 percent in March, led by a surge in motor vehicle production. Consumer spending increased at a robust rate supported by strong income gains and higher wealth from the fourth quarter of 2004 into the first quarter of this year. The expansion is set to continue through to end-year although a retrenchment in private consumption remains a risk, particularly if house price increases were to slow. The US trade deficit widened in the first two months of this year driven by upsurge in non-fuel imports of goods and services.

In China, growth was estimated at a faster-than-expected rate of 9.5 percent in the first quarter of 2005, well above the 8 percent official target, notwithstanding tightening measures by the authorities. The increase in GDP surpassed most analysts' expectations of 9 percent growth in the first quarter. The level of investment remains very high particularly in the construction sector. Fixed investment in the first three months of the year went up by 22.8 percent compared with 43.0 percent during the corresponding period last year. The construction industry is one of the main focuses of investors, with luxury apartment blocks shooting up across China's big cities. But the rate of expansion signals the need to raise interest rates, which the People's Bank of China did in October 2004 for the first time in nine years.

China's overall trade surplus was US$16.6bn in the first quarter as exports surged 34.9 percent. According to the WTO, China has overtaken Japan as the world's third largest exporter after a surge in demand for electronic goods led to a 35 percent increase in the country's overseas sales. However, tightening of policy leading to slow down in investment activity in the US and China was likely to moderate economic activity and thus trade growth this year, the WTO said.

In the euro area, GDP growth has been low in recent months but figures for the first quarter to be released next month, are forecast to show a rebound compared with the last three months of last year. Growth in the euro area has been hampered by weak final domestic demand, and the contribution of net exports has turned sharply negative. While some tentative signs of renewed growth are emerging, recent confidence surveys have suggested second quarter figures will show a slowdown again. Amidst all these developments, the ECB has ruled out a cut in interest rates, saying a decrease was not an option.

In UK, GDP growth was estimated at 3.1 percent in 2004 after accelerating in the last quarter of the year, according to the Office of National Statistics (ONS). Led by the services sector, which accounts for three-quarters of the UK economy, this growth rate compares favourably with the 2.2 percent recorded in 2003 and the economy is said to be on course in the first quarter of this year to continue this growth trajectory.

Japanese industrial production rebounded by a stronger-than-expected 2.1 percent month-on-month in January amid renewed signs that the recession in Japan appears to have bottomed out. But the trade ministry survey, released on April 19, 2005 forecast a decline in output of 0.5 percent in February and a further fall of 1 percent in March attributed to weak exports, consumption and investment.

Economic growth in Sub-Saharan Africa was estimated to have reached an eight-year high of 5 percent last year and prospects in 2005 remain largely unchanged. Real GDP per capita increased by 2.7 percent aided by prudent macroeconomic policies, buoyant commodity prices, improved weather conditions and debt relief under the Heavily Indebted Poor Countries (HIPC) initiative. Possible risks to the outlook include civil conflicts in the region, vulnerability of many countries to droughts and other natural disasters, and uncertainties in the foreign exchange and oil markets. However, an increase in overall development assistance in the context of strong reform efforts could enhance the region's prospects for higher growth and poverty reduction.

The average growth rate for the entire region is projected to remain unchanged at around 5 percent in 2005 with output growth in most oil producing countries forecast to remain close to 5 percent (Nigeria, Angola, Chad and Equatorial Guinea). Senegal, Madagascar, Mozambique, Sierra Leone and Tanzania are all projected to grow in excess of 6 percent. In Nigeria, economic performance has largely been driven by developments in the oil and gas sectors. The economy is projected to expand by 7.4 percent this year as a major offshore oil field and two new liquefaction trains come on stream. Strong growth in South Africa continued to be driven by buoyant domestic demand and low interest rates. In other non-oil producing countries, economic activity is expected to be stimulated by a rise in investment, projected to increase by 0.2 percentage points to 18.7 percent of GDP in 2005. However, exports as a percentage of GDP are expected to fall by 0.2 percent reflecting reduced import demand from advanced economies. There are four dark spots in the region with growth in real GDP estimated at below 2 percent – Cote d"Ivoire, Gabon, Seychelles and Zimbabwe (Regional Economic Outlook, IMF, April 2005).

In the Middle East, growth is projected to ease as oil revenues drop (output) owing to limited excess capacity. The volatility in the oil market and the prospect that oil prices may rise further offers the region the opportunity to address fiscal imbalances and deepen reforms. Unemployment remains high in the region and the labour force is growing very rapidly.

B. Consumer Prices

Inflation and inflationary expectations have remained generally subdued with few signs of pass through from higher oil prices. Most central banks have tightened monetary policy and with inflationary expectations well grounded, the outlook for higher consumer prices remain moderate. However, there is scope for higher inflationary pressures as the expansion progresses with significant rebound in labour markets. Another upside risk to inflation also relates to the problem of dealing with large capital inflows especially where exchange rates are not flexible, notably in Asia and the CIS.

In the US, inflation rose faster than expected in February with the consumer price index climbing by 0.4 percent over the month, the largest monthly gain since October. In 2004, consumer prices had risen 3 percent. Owing to the presence of economic slack and benign labour market conditions, inflation and inflationary pressures have remained generally modest and second-round effects of the increase in energy prices have been well contained. Looking forward, the authorities still have room to hike rates from their current levels before monetary policy becomes more neutral.

Eurozone consumer price inflation rose 0.7 percent from February with annual inflation of 2.1 percent (European Union statistics office). According to Eurostat, the monthly rate is in line with expectations and was buoyed by a seasonal increase in the price of clothing. Garments accounted for 0.26 percentage points of the rise, followed by fuels for transport with 0.10 percentage points. The ECB defines price stability as keeping the eurozone consumer price index below but close to 2 percent over the medium term.

In the UK, inflation unexpectedly rose in March driven by higher oil prices, which pushed up airfares, heightening fears that the Bank of England will have to raise interest rates again. Consumer prices rose by 1.9 percent from a year ago, the highest rate since May 1998 and the closest actual inflation has come to the 2.0 percent target. Quarterly inflation rose to 1.7 percent, way above the MPC's projection in February of 1.5 percent. It also raised concern that inflation is rising at a time when the global economy is starting to weaken, which will make it extremely difficult for policy makers to set an appropriate level of interest rates. Inflationary pressures came from food and non-alcoholic beverages. Furniture, clothing and footwear were also more expensive this year compared to last year.

C. Interest Rates

With policy interest rates in most countries considered generally well below neutral levels, there is growing concern that most regions will need to hike interest rates as the expansion proceeds. However, given the divergence in growth rates, the appropriate timing and pace differ (WEO, April 2005). The level of investment in China calls for monetary conditions to be tightened; in the United States, a measured pace of tightening remains appropriate for the time being. At its meeting on March 22, 2005, the Federal Open Market Committee (FOMC) decided to raise the federal funds rate by 25 basis points to 2.75 percent.

In the eurozone, the ECB has kept interest rates at 2 percent for 22 months running. The President of the ECB Jean-Claude Trichet, again ruled out a cut in rates, saying a decrease was “not an option”. Until the end of March, analysts had forecast a quarter percentage point increase by December but that is no longer the case. Policy should remain on hold until a self-sustaining recovery is well under way, and if the current economic weaknesses persist and inflationary pressures remain subdued, then the possibility of rate cuts cannot be ruled out.

In the UK, the Bank of England’s 7-member committee voted to leave its rate unchanged at 4.75 percent for the eight month in a row amid uncertainty over slow consumer spending and the direction of consumer prices. Majority of committee members argued there was insufficient evidence of rising inflation rates. In Japan, analysts expect the quantitative easing to be maintained until deflation disappears and the economy picks up before rates could be changed.

D. Commodity Prices

Despite moderating growth, oil prices have remained high and largely volatile. Average spot prices reached $54.30 in early April, representing an increase of 73 percent from the beginning of 2004. The increase in oil prices could be attributed to robust global demand for oil, temporary supply shocks, heightened geopolitical uncertainties and limited excess capacity. The robust growth in global demand for oil emanated from the ongoing expansion in Asia (notably China) and North America. China contributed the most to the increase in demand for oil (0.86 mbd during 2004) followed by North America (0.61 mbd) and other non-OECD Asian countries (e.g. India 0.45 mbd).

While the price of the heavier grade of crude was subdued in the last half of 2004, that of the sweet light soared resulting in high spreads between light and heavy crude. Global refining capacity is limited to simple distillation that is unable to process the heavier crudes, the conversion process is costly and can take years to implement.

Looking forward, April prices remain well above the baseline projections. Demand and supply conditions for 2005 point to high crude oil prices and there is little evidence of a slow down in Chinese demand for diesel fuel in particular.

Non-fuel commodity prices rose by 3 percent in dollar terms during July 2004 – March 2005, with beverage and metals contributing the most to the rise. Cotton prices fell by 34 percent relative to 2003 levels, soybeans prices easing by 21 percent, and sugar, rice, pork and coffee prices all rising by at least by 30 percent. As a result of the combined effects of a record harvest and slower growth in demand, the prices of agricultural raw materials declined in the second half of 2004.

In 2005, the on going expansion is expected to support commodity prices. Nonetheless, non-fuel commodity prices are expected to slow owing to favourable harvest and weaker demand resulting from higher metal prices.

(2.0) Balance of Payments (BOP)

Government's external sector policy in the medium to long-term is aimed at ensuring sustainable BOP as well as build up reserves adequate to cushion the economy against external and internal shocks. Foreign currency reserves are projected to cover at least 4.7 months of imports in 2005.

The overall balance of payments is projected at a surplus of D27.3 million compared to D797.8 million in 2004. The current account balance including official transfers is estimated to deteriorate significantly as a result of the projected widening of the trade deficit. In contrast, the balance in the capital account is expected to improve due to the projected increase in private capital inflows.

Current Account

(i) Merchandise Account

The trade deficit is expected to widen from D1.7 billion in 2004 to D2.0 billion in 2005 reflecting an upsurge in imports which should more than offset exports. Domestic exports are projected at D937.4 million, an increase of 21.9 percent with groundnuts and groundnut products accounting for about 69.0 percent of total domestic exports. Re-exports are estimated at D2.9 billion, representing 75.8 percent of total exports.

Imports are projected to expand to D5.9 billion, or 13.0 percent from 2004 reflecting the rebound in re-exports, increased public sector investment and the effects of the higher oil import bill. Imports for domestic use are estimated at D4.0 billion compared to D3.4 billion in the 2004 while oil and oil products imports are expected to increase to D719.3 million compared to D604.8 million in 2004.

(ii) Services and Private Transfers Account

The balance in the services account (net), comprising factor and non-factor services, is estimated at a deficit of D622.2 million compared to D230.8 million in 2004. The factor services balance (net) deficit is projected to worsen from D663.6 million in 2004 to D1.0 billion in 2005 owing to increased interest payments on the external debt. Net interest income, which recorded a deficit of D1.1 billion in the previous year, is projected to deteriorate to D1.5 billion in 2005.

The surplus of non-factor services is projected to decline to D388.2 million compared to D432.8 million in 2004. Travel income is estimated at D1.9 billion, representing an increase of 7.8 percent while net outflow on account of freight and insurance is expected to increase by 13.0 percent to D836.6 million, owing to the projected increase in imports.

Private unrequited transfers (net) is projected to increase by 7.1 percent to D126.1 million while net official transfers (project aid) is forecast to decline by 26.0 percent to D875.9 million. Remittances, on the other hand, are estimated to increase to D494.8 million compared to D440.3 million in 2004.

Capital Account

The capital account is projected at D1.6 billion compared to D1.4 billion in 2004. Official loans (net) is estimated to decrease to a surplus of D344.3 million, or 6.0 percent due to the estimated increase in amortization from D372.2 million in 2004 to D562.8 million in 2005. Project-related loans are projected at D800.0 million compared to D738.5 million in the previous year. Programme loans are estimated at D107.1 million from zero in 2004. Private capital inflows should increase to D1.3 billion relative to D1.0 billion in 2004 comprising foreign direct investment (net) of D1.2 billion and other investments (D123.8 million).

Overall Balance and Financing

The overall balance of payments is estimated at a surplus of D27.3 million compared to D797.8 million in the previous year. Gross official reserves are projected at $85.4 million, equivalent to 4.7 months of import cover. Disbursements from the IMF are projected at D262.8 million, which more than offset repayments totalling D61.2 million. Exceptional financing is projected at zero and The Gambia is expected to be current on its debt service payments.

(3.0) Monetary Developments

Growth in money supply accelerated to 24.0 per cent higher than the programmed target of 5.2 percent, but lower than the 31.5 per cent growth rate a year earlier. Both components of money supply increased.

Narrow money (M1), comprising currency outside banks and demand deposits increased to D3.4 billion, or 19.5 per cent from the pervious year. Currency outside banks and demand deposits rose by 16.3 per cent and 22.5 percent respectively. The ratio of narrow money (M1) to broad money (M2), however, declined from 60.6 per cent at end-February 2004 to 58.5 percent at end-February 2005.

Quasi-money (time and savings deposits) rose to D2.4 billion, or 30.9 percent over the previous year. Savings and time deposits increased by 25.3 percent and 52.2 percent respectively. Correspondingly, the share of quasi-money to broad money rose from 39.4 percent at end-February 2004 to 41.5 percent at end-February 2005.

(3.1) Factors Affecting Money Supply

(a) Net Foreign Assets (NFA)

The net foreign assets of the banking system rose to D3.4 billion, or 58.2 per cent from the preceding year mainly reflecting the combined effects of an increase in the net foreign assets of the Central Bank and commercial banks.

The NFA of the Central Bank increased to D2.0 billion, or 74.4 percent. Gross official reserves rose to D2.8 billion or 25.4 percent while foreign liabilities decreased to D0.7 billion, or 30.7 percent.

Deposit money banks' net external position rose to D1.3 billion, or 38.5 percent notwithstanding the 335.2 percent increase in their foreign liabilities. Deposit money banks foreign assets increased to D1.5 billion, or 46.2 percent over the previous year.

(b) Net Domestic Assets (NDA)

The NDA of the banking system decreased to D2.4 billion, or 4.8 percent from the previous year. This was attributed mainly to the decline in domestic credit by 13.8 percent. Lending to all the sectors decreased. Credit to public entities declined to D194.9 million, or 18.6 percent while net claims on Government fell by 25.4 percent to D1.1 billion largely reflecting increased Government deposits of 101.7 percent and reduced recourse to bank borrowing particularly from the Central Bank. Central Bank's net claim on Government declined to D240.7 million, or 148.2 percent. Private sector credit decreased by 3.6 percent from a year earlier to D1.7 billion.

(3.2) Reserve Money

Reserve money consists of currency issued and bank deposits with the Central Bank. It is a measure of the Central Bank's monetary liabilities and captures the impact of all the Central Bank's operations on banks' liquidity and it's potential for credit expansion in the economy. Given the fact that the initial link between monetary policy and the rest of the economy occurs in the market for reserves, monetary policy was conducted by the Central Bank using reserve money as an operating target.

During the year under review, policies were directed at preventing excessive liquidity that might result to a built up in inflationary pressures while at the same time providing enough liquidity to ensure sustained economic activity.
Reserve money grew by 15.6 percent above the end-March 2005 target of 1.2 percent but below the substantial growth rate of 34.2 percent in the previous year. The robust growth in reserve money was largely on account of the increase

in NFA of the Central Bank, which rose by 74.4 percent to D2.0 billion. Gross official reserves increased by 25.4 percent to D2.8 billion while foreign liabilities decreased by 30.7 percent to D708.1 million.

In marked contrast, the NDA of the Central Bank declined significantly by 73.9 percent to D200.9 million. Central Bank's net claim on Government declined by 148.2 percent owing to the 101.7 percent increase in Government deposit and the 4.6 percent decrease in gross claims against Government. Central Bank's claims on public entities remained unchanged at D136.9 million while private sector credit declined to D213.0 million, or 7.5 percent.

With respect to the demand for reserve money, the growth rate of currency in circulation declined to 15.4 percent from 44.9 percent in the previous year. Deposit money banks reserves increased by 15.9 percent compared to 11.4 percent a year ago.

(4.0) Money Market Developments

As at end-March 2005, the total outstanding stock of the interest bearing debt rose to D5.2 billion or 15.55 per cent from end-December 2004. The marketable interest bearing debt stock comprised:

Treasury bills – 73.80%
Development stock – 0.40%
Discount note series – 2.30%
Others - 23.5%

The non-bank public, including parastatals held the bulk of the interest bearing debt (49.6 per cent) followed by the deposit money banks (31.6 per cent) and CBG (18.8 per cent).

(4.1) Distribution of Treasury Bills by Holder

A desegregation of Treasury bills holdings as at end-March 2005 shows that the non-bank held the bulk of the stock (58.8 per cent) followed deposit money banks (39.7 per cent) and the Central Bank (1.5 per cent). At end-December 2004, CBG holdings of Treasury bills accounted for 2.6 per cent of the total, deposit money banks (38.7 per cent) and non-bank (58.5 per cent). However, it is important to note that a public enterprise held 56 percent of the total non-bank holdings and 27.0 percent of the total outstanding Treasury bills while one bank held 60 percent of the total deposit money bank holdings and 21 percent of the outstanding stock of Treasury Bills.

(4.2) Distribution of Treasury Bills by Maturity

At end-March 2005, 1-year bills accounted for 49.66 per cent of total Treasury bills, 91 – day bills (33.65 per cent) and 182 – day bills (16.69 per cent). In the quarter ending December 2004 , the picture was somehow similar. The 364 – day bills accounted for 50.95 per cent of the stock, 182 – day bills (9.50 per cent) and 91 – day bills (38.51 per cent).

(4.3) The Yield Curve on Treasury Bills

The yield curve of the Gambia's money market has been generally flat. However, between October 2004 and March 2005, the declining trend in the policy rate coupled with the high demand for Dalasi-denominated assets caused the discount rate on Treasury bills to decrease. The Treasury bills rate gradually fell from 31 percent in September 2004 to 30 percent in October, 28 percent in December 2004 and 26 percent in February 2005.

(5.0) Private Sector Business Sentiment Survey

The purpose of the survey is to obtain data on an area of the economy that is not well covered by official data and to monitor business and economic conditions. The panel was carefully selected to accurately replicate the true structure of the formal economy.
Respondents reported a much higher economic activity at both the company and country level in Q1, 2005 relative to Q4, 2004 which bodes well for growth in 2005.

Panel firms' expectation on inflation and exchange rates was more positive than was the case in the previous survey attributed to the noticeable receding of inflationary pressures and the strengthening of the Dalasi in the foreign exchange market. Respondents also expect interest rates to be lower premised on the declining trend of the policy rate.

(6.0) Real Sector

Economic growth is forecast at 5.0 per cent in 2005 compared to 8.3 per cent in 2004. The value added of all the key sectors: agriculture, industry and services are projected to increase.

(6.1) Agriculture

Agricultural output is estimated at 4.7 per cent compared to 14.2 per cent in 2004. The value- added of groundnuts is projected at 3.0 per cent, other crops (5.0 per cent), livestock (5.0 per cent), forestry (5.0 per cent), and fishing (7.0 per cent).
Agricultural production for the 2005/6 crop season is estimated to increase by 4.7 per cent from a year earlier. Food crops such as sorghum and millet are expected to maintain their positive growth trajectory while groundnut production is projected at over 100,000 metric tonnes assuming normal rain fall and timely availability of seeds and fertilizer. With agriculture accounting for 32 per cent of

GDP at factor cost in 2004, the sector would remain the main engine of growth in 2005.

Groundnut trade for the 2004/05 season has performed below expectation. Figures released by the only licensed trading company, GAMCO show that 31, 319 tonnes have so far been purchased out of an estimated total output of 135, 000 metric tonnes. About less than half the tonnage purchased has been evacuated to Denton Bridge, destined for export, and the rest is stored at various locations in the country.

(6.2.1) Industry

Industrial output is projected at 5.9 per cent, the same as in 2004, premised on robust growth of manufacturing (6.0 per cent), construction and mining (6.0 per cent) and electricity and water (5.0 per cent).

(6.2.2) Services

The services sector is forecast to grow by 5.0 per cent, slightly lower than the 5.8 per cent in 2004. Trade and hotels and restaurants output are estimated at 5.6 per cent and 10.0 percent compared to 7.5 per cent and 20.0 per cent respectively in 2004. The output of public administration is estimated at 3.0 per cent higher than the 1.0 per cent in 2004 while the value added of transportation and communications, real estate and business services and other services (banking insurance, personal and household services, social and recreational and related services) are forecast to grow by 5.0 per cent, 3.0 per cent, and 3.0 per cent respectively, the same as the actual output in the preceding year.

Risks to the GDP Forecast

(i) Unforeseen changes in oil prices from the current $54.3 per barrel mark, which could cause severe terms of trade shocks.

(ii) Less-than-expected increase in tourist arrivals;

(iii) Budgetary slippages

(IV) Poor agricultural output.

(7.0) Fiscal Developments

Total domestic revenue increased to D646.6 million, or 5.0 per cent over the previous quarter. On an annual basis, however, domestic revenue increased by only 1.2 per cent. Domestic revenue out-performed the end-March 2005 target of D642.7 million by D3.9 million. There were no program and project grants during the quarter under review.

Indirect taxes, accounting for 60.6 per cent of total tax revenue, decreased to D391.9 million, or 8.4 per cent and was below the target of D405.8 million by 3.4 per cent. Taxes on petroleum products, accounting for 13.8 per cent of tax revenue increased significantly to level off at D77.9 million, or 30.1 per cent from the previous quarter. However, compared to a year ago, taxes on petroleum products contracted by 3.5 percent.

Direct taxes increased by 44.3 per cent from the previous quarter to D173.5 million but fell, albeit marginally by 0.5 per cent from a year earlier. Non-tax revenue rose to 81.2 million or 16.7 percent from the last quarter and by 50.6 percent year-on-year.

Total expenditure and net lending fell substantially to D694.2 million, or 20.5 per cent from the last quarter, mainly on account of the sharp decline in capital expenditure.

Capital expenditure fell from D224.0 million at end-December 2004 to D30.1 million at end-March 2005. Compared to a year ago, capital expenditure decreased by 95.8 per cent. With no new loans and/or program grants, capital expenditure was financed entirely from domestic sources.

Current expenditure increased marginally from D648.9 million at end-December 2004 to D664.1 million at end-March 2005. Compared to the first quarter of 2004, current expenditure rose by 38.0 per cent owing mainly to increased wages and salaries by 12.8 per cent.

Interest payments totaled D336 million compared to D315.0 million at end-December 2005. Domestic interest payment (80.7 per cent of total interest payments) amounted to D271.2 million while interest payments on external debt totaled D64.8 million.

On commitment basis, the fiscal deficit (including grants) was D47.4 million at the end-March 2005 compared to D183.2 million in the previous quarter and D333.6 million in the corresponding quarter a year ago.

However, the budget deficit (excluding grants and HIPC funds) narrowed to D45.4 million compared to D195.5 million at end-December 2004 and D513.2million a year earlier. The budget deficit was financed entirely from domestic sources.

(8.0) Financial System Soundness Indicators

Capital Adequacy Ratio

The average capital adequacy ratio for the industry increased from 20.2 percent in quarter four 2004 to 82.81 percent during in quarter one of 2005. This was mainly due to the entry into the market of a well capitalized bank with no risky assets. Excluding the new bank, the ratio declines to 19.4 percent. The lowest ratio was 13.4 percent and the highest 444.2 percent compared to the minimum capital requirement of 8 percent meaning that the banks have enough cushion to absorb losses.

Asset Quality

The industry’s total assets rose to D7.0 billion in quarter one, 2005 compared to D6.7 billion in quarter four, 2004 and D6.7 billion a year ago. Non-performing loans decreased to D179.1 million, 15.1 percent from the previous quarter. The ratio of non-performing loans to total loans was 10.4 percent, which compared favourably to 12.9 percent in quarter four, 2004. Actual provisioning totaled D137.6 million, higher than the recommended provisioning of D122.4 million. Thus, there was excess provisioning of D15.2 million.

Earnings

The industry’s Return on Assets rose from 1.2 percent in quarter four, 2004 to 4.7 percent in quarter one 2005 attributed to the fact that profits rose faster than assets. Interest income decreased by D16.2 million to D184.6. Non Interest income, on the other hand, increased by D4.3 million to D108.4 million. Return on equity was 9.1 percent compared to 5.2 percent in the preceding quarter.

Liquidity

The average liquidity ratio was 155.7 percent, reflecting an increase of 67.2 percent over the previous quarter. The main reason for the increase was the fact that the new bank held a large stock of liquid assets. Excluding the new entrant, average liquidity ratio was 80.5 percent. The lowest ratio was 52.4 percent and the highest 606.8 percent, which compares favorably to the minimum requirement of 30 percent.

(9.0) Inflation Outlook and analysis

End-period inflation, measured by the consumer price index of low-income population of Banjul and Kombo St Mary area, declined from 17.7 percent in February 2004 to 5.7 percent at end-February 2005. Average inflation rate (12 month moving average) was 12.2 percent compared to 17.9 percent a year earlier.

Food consumer price inflation declined to 6.7 percent compared to 19.4 percent in February 2004. Prices of all food sub-groups declined. ‘‘Cereals and cereal products’’, ‘‘ roots, pulses, nuts and seeds’’, ‘‘ vegetables and fruits’’, ‘‘meat, poultry, eggs and fish’’ , ‘‘milk and milk products’’ and other foods consumer price inflation decelerated to 13.7 percent, 4.4 percent, 3.2 percent, 4.1 percent, 6.3 percent and 8.9 percent compared to 27.6 percent, 15.0 percent, 6.9 percent, 16.6 percent, 17.6 percent and 29.5 percent respectively in the previous year. Non-food consumer price inflation declined to 3.5 percent compared to 14.6 percent at end-February 2004.

(9.1) Core Inflation

The first measure of core inflation (Core 1), which excludes energy prices (fuel, light and transportation) declined from 15.8 percent in February 2004 to 4.6 percent in February 2005.

Core 2 which strips out prices of energy and utilities and volatile food items (‘‘ meat, poultry, eggs and fish’’, ‘‘tobacco and tobacco products’’, ‘‘cereals and cereal products’’, and ‘‘processed foods’’) decelerated from 12.2 percent in February 2004 to 0.9 percent February 2005.

(9.2) Inflation Forecast

Assumptions:

(i) Stable exchange rate;
(ii) Money supply growth of 10 percent;
(iii) Government expenditure and net lending of 26 percent of GDP with zero central bank financing of the budget deficit.

The quarterly 2005 forecast is as follows:

Quarter 2	-	2.4
Quarter 3	-	1.6
Quarter 4	-	1.6

(9.3) Factors that might affect the inflation dynamics in 2005

(i) Sharp depreciation of the Dalasi would not only increase the input cost of manufacturing, but impacts inflation directly via imported consumption goods;
(ii) Larger-than-expected budget deficit and concomitant increase in financing, including Central Bank financing;

(iii) Sustained increase in world oil prices could put pressure on the exchange rate and inevitably consumer prices.